

# BEACON STREET CAPITAL, LLC

INVESTMENT MANAGEMENT

## *Institutional-level Money Management for Individuals*

July 1, 2008

### Highlights

- Our S&P500/Select strategy outperformed the S&P500 Index by 500 basis points and the Russell 1000® Growth Index by 102 basis points for the second quarter 2008.
- Volatility for our portfolios remains significantly less than their benchmark indices. This dramatically improves the impact of compounding on long-term returns.

**Our Mission:** To provide a better way to invest in large-cap stocks.

**Our Objective:** To achieve significant alpha with low volatility over a 3-5 year horizon.

**Our Products:** Separately Managed Accounts of individually selected large-cap growth stocks.

### Second Quarter 2008 Newsletter

A big jump in oil prices and the credit contraction experienced by financial institutions caused investors to reassess the fate of consumers and businesses worldwide during the second-half of the second quarter. The result was another quarterly decline in the S&P500 Index by -2.73%. In contrast our S&P500/Select large-cap growth strategy gained +2.27%.

The S&P500 Index has now fallen -19% from its high reached last October. Prior to that the index had risen about +92% from its Bear Market low in late 2002, so a -19% decline is neither unusual nor a disaster. Although nerve racking these periodic declines are necessary in order to drive out the excesses that occasionally occur in the stock market. They also provide an opportunity to invest in high quality stocks at much lower prices for those with the courage to follow their discipline.

Regarding the credit crunch, the Fed and central banks around the world are allowing financial institutions to buy time to work through their bad debt problems as they re-build their capital bases. This will dilute shareholder value and cause some firms to be acquired or close, but it is not the end of the world. The Savings & Loans took years to work through a similar situation a number of years back without imploding the economy.

Regarding oil prices, information we have studied indicates they should decline over the next six months as the Middle-East risk premium is reduced. These sources indicate the US and Iran could reach an agreement over Iraq due to the efforts of Saudi Arabia, which desires a buffer between itself and Iranian expansion. They also believe Israel and Syria will reach a peace deal soon to avoid dealing with a new US administration after the November elections. Couple this with the IMF and IEA having cut their forecasts for oil demand and oil prices could drop even further.

Best Regards,

*BEACON STREET CAPITAL, LLC*

BEACON STREET  
CAPITAL, LLC

3350 Riverwood Pkwy  
Suite 1900  
Atlanta, GA 30339

Tel: 770-984-5433  
www.beaconstreetcapital.com

All results are un-audited and net of fees. Composite returns began January 2002 for the S&P500/Select and April 2002 for the DowJones/Select, are asset weighted and net of fees. Returns prior to November 2001 and March 2002 are total returns for model portfolios managed by Beacon Street Research, Inc., an affiliated company, on a real-time basis using the same methodology and manager, with stocks selected from those comprising the Standard & Poor's 500-Stock Index and Dow Jones Industrial Average. Past performance is no indication or guarantee of future performance.

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**Exhibit 1:  
DowJones/Select**

**Top Ten Holdings**

McDonalds Corp	8.8%
Caterpillar Inc.	8.4%
IBM Corp	8.4%
Procter & Gamble Co	6.9%
Johnson & Johnson	6.8%
Microsoft Corp	6.8%
Intel Corp	6.6%
AT&T Inc	6.4%
Coca-Cola Co	6.2%
United Technologies	6.0%

**Exhibit 2:  
S&P500/Select**

**Top Ten Holdings**

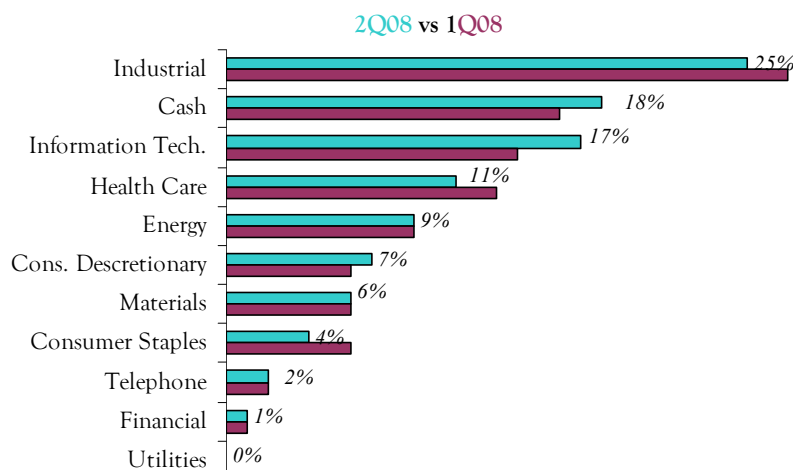
Monsanto Co	3.5%
Apple Inc	2.8%
C S X Corp	2.6%
Gilead Sciences Inc	2.4%
Halliburton Co	2.4%
Praxair, Inc.	2.3%
McDonalds Corp	2.1%
Noble Corp	2.0%
National Oilwell Varco	1.9%
Caterpillar, Inc.	1.8%

In our *Market Insights* last quarter I said, “The first quarter of 2008 was dismal for the stock market, as evidenced by the worst quarterly performance for the Dow Jones Industrial Average in 5½ years...” Now we add to that another poor quarter with the Dow Jones Industrial Average (DJIA) off another -7.44%, almost identical to the first quarter’s decline of -7.55%, and we have the worst six month start to a year for the DJIA since 1970, with the index lower by -14.44%. Equity market indices were well into the black for the first two months of the quarter before falling out of bed in June with the DJIA posting its worst monthly performance (-10.2%) since September 2002, just before the most recent bull market began. That period of time, like this one, showed high market volatility with monthly returns gyrating wildly in both directions as the market ground to a low point before starting the move to new all-time highs.

The improvement in the markets in the first half of the quarter came as market participants were bolstered by the beliefs that the worst of the credit crunch may be behind us, that earnings growth would begin to pick up again and that stocks were poised to rise as a more favorable economic backdrop unfolded. But those hopes turned to disappointment as the credit crisis lingered, oil prices moved into historically unseen territory and as the fear that consumers may stop spending began to look like a reality. The worst performing group in the quarter was Financials which were down 19%. The best performers were Energy (up 17%), Utilities (up 7%), Materials (up 4%) and Technology (up 2%). Fortunately we were under-weighted in Financials and had a market weighting in Technology, an overweight in Materials and a significant but still underweight in Energy. The relentless rise in the world price of oil has stoked not only fears of falling economic growth, but also rising inflation. Consumers are using more of their discretionary spending dollars for gasoline and less for other consumer goods that drive our economy and also drive corporate profits.

Meanwhile, since last quarter, the government “stimulus checks” in the form of the tax rebate have been distributed to taxpayers and appear to have been spent at low-cost retailers like Wal-Mart and Costco as their sales figures for June were greater than they had been predicting. However, as we mentioned last quarter,

**Exhibit 3: S&P500/Select Sector Weighting**



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these rebates are simply a redistribution of current tax receipts that will increase the deficit in the short-term and will have to be “paid for” with additional tax receipts or additional borrowing in the longer-term. Now our representatives in Washington are beginning to make overtures about additional stimulus measures that will increase the deficit while adding little if any to longer term growth potential. In addition the presidential election season is upon us and it seems the candidates of both parties are going to continuously cater to the electorate with promises of jobs and financial security that are not only beyond the scope of the office of the President, but also potentially beyond the means of our Treasury should the new President and Congress actually follow through on the promises.

This current market downturn has in many ways felt similar to a long trip in an automobile packed with small children. It has been uncomfortable, even maddening at times, and has seemed to go on forever. But market downturns, much like long road trips in an automobile, while painful, eventually come to an end and we get to enjoy the attractions at the destination. At some point this trip too will end and better days will begin. Data compiled by Morningstar shows that if an investor was out of the market for US large cap stocks for the best 40 months over the past 80 years they would have missed out on the vast majority of the returns provided by the market. The annualized returns would have been 3.7% missing the best 40 months versus 10.4% being fully invested all the way through. So while it may be tempting to get out when the kids are screaming, we do not reach our ultimate destination by exiting when times are difficult. We do not know when the “best 40 months” will occur but we do know we do not want to be “out of the car” when they do transpire.

We have built up more cash, currently 20%, that cushions our portfolios in times like these. But this cash is also because we are not getting as many “buy” signals for our universe of companies as we have in the recent past. So we are sticking to our discipline that allows us to maintain our composure and also build a bit more cash in uncertain markets. We still do not believe all of the bad news is out yet regarding the mortgage and housing markets and the escalating price of oil continues to be a headwind for the US economy as well as economies around the globe. But as we have said before financial market recoveries generally begin well before the end of economic downturns and before all of the bad news hits the news wires, so we remain optimistic that things will get better in the not too distant future. Obviously only time will tell whether this is true but we will continue to invest for the long-term and believe our approach will provide significant positive returns for our clients and ourselves over time.

*Herron P. Weems*  
*Managing Director*

### Performance Summary

**DowJones/Select:** We sold Wal-Mart during the quarter at \$57.31. We had recently received negative signals on Wal-Mart and our current thinking was that the stimulus checks from the government would represent a one time boost to sales and that the current price (which had moved up 33% from its September 2007 low) most likely reflected that. With the consumer getting weaker all retail stocks should eventually correct to a lower price to reflect slower earnings growth. We also added to our position in United Technologies Corp. this quarter.

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The Dow Jones Industrial Average, our primary benchmark which reflects mega-cap, blue-chip, dividend paying stocks, declined -7.44% for the quarter, hurt once again by its exposure to multiple financial stocks. Our one exposure to financial stocks, AIG, declined -39% and was responsible for a large percentage of the decline of -5.62% in our DowJones/*Select* portfolio composite. We purchased AIG six months ago at a 15% discount from its recent high, after the company reported they were not materially exposed to the subprime mortgage market which caused financial institutions to take huge mortgage-related write-downs. That proved to be untrue as AIG subsequently reported a \$7.8 billion loss in the first quarter of this year, driven by \$19.3 billion in cumulative unrealized market valuation losses. Since then the CEO has been fired (with a parting kiss of \$47 million); the company has been forced to raise \$20 billion of equity and hybrid-equity securities; the Justice Department is probing its valuation methods; a Florida pension fund has filed a lawsuit claiming false and misleading statements were made prior to its first quarter write-downs; and shareholders are stuck with a stock that has sunk another 55%. Even with the return drag related to AIG, with 20% cash and high quality stocks making up the balance of our holdings, our DowJones/*Select* composite exceeded the Dow's quarterly return by 182 basis points and its most recent one-year return by 850 basis points.

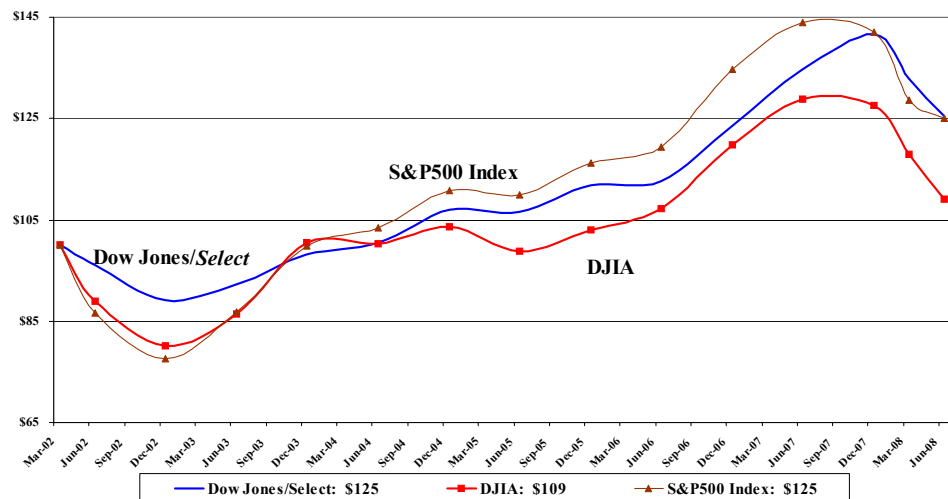
Aside from AIG, our Consumer Staple stocks (KO and PG) and Industrial stocks (BA, CAT and UTX) declined approximately 14% and 10% respectively. Telecom (AT&T) declined 11%. On the plus side the Consumer Discretionary (MCD) sector gained 1%; Health Care (JNJ) was flat, and the IT sector (Intel, IBM and MSFT) gained about 2%.

Exhibits 4, 5 & 6 below show the performance of this Mega-cap core strategy.

Exhibit 4: Net Returns vs Benchmarks				
	2Q08	1Year	3Yr. Avg	Inception
DowJones/ <i>Select</i>	-5.62%	-6.85%	5.52%	3.62%
Dow Jones Ind. Avg.	-7.44%	-15.35%	3.37%	1.40%
S&P500 Index	-2.73%	-13.12%	4.41%	3.55%

Exhibit 5: Value of \$100 Invested April 2002 – June 2008

### Beacon Street Capital - Dow Jones/*Select*



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Exhibit 6: 6 Year Statistics (June 2002 – June 2008)				
DowJones/Select vs S&P500 Index				
Alpha	Standard Deviation	Tracking Error	Sharpe Ratio	Information Ratio
1.13%	8.13 vs 12.47	8.51	0.36	-0.18

Source: Informa Investment Solutions

**S&P 500/ Select:** During the second quarter we purchased seven new stocks and sold eight for this strategy, leaving a total of 54 stocks in the composite portfolio. This gave us new positions in Industrials (Illinois Tool Works Inc, Precision Castparts Corp and Textron Inc) after selling Cooper Industries and ITT Corp. We added Covance Inc to our Health Care sector and TJX Cos and Nike Inc to our Consumer Discretionary sector. In the Consumer Staples sector we sold Anheuser-Busch Cos Inc, Wal-Mart Stores Inc and PepsiCo Inc, while adding UST Inc. All of the stocks we added have a majority of their sales exposure in the international economy, yet all but Covance (+5%) and UST (+2%) declined with the market. The cash position in this strategy increased slightly to 18%

The second quarter and longer-term composite performance for this Large Cap Growth product can be seen in Exhibits 7, 8 and 9. Part of our outperformance is, and has been, our lack of exposure to the financial sector (less than 1% of the portfolio) and the positive growth potential for the stocks we own.

Exhibit 7: Net Returns vs Benchmark				
	2Q08	1 Year	3Yr.Avg.	Inception
S&P500/Select	2.27%	-3.81%	7.38%	5.29%
S&P 500 Index	-2.73%	-13.12%	4.41%	3.55%
Russell 1000® Growth Index	1.25%	-5.95%	5.91%	2.33%

Exhibit 8: Value of \$100 Invested January 2002 – June 2008

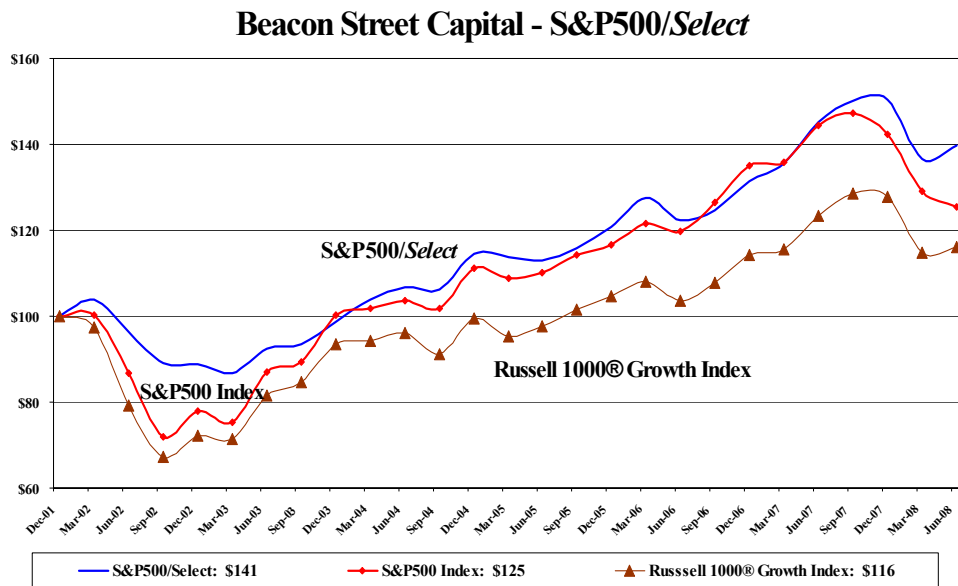


Exhibit 9: 6 Year Statistics (June 2002 – June 2008)				
S&P500/Select vs Russell 1000® Growth				
Alpha	Standard Deviation	Tracking Error	Sharpe Ratio	Information Ratio
2.57%	8.50 vs 12.31	7.00	0.58	0.06

Source: Informa Investment Solutions

**Institutional LCG:**

Institutional investors seek to gain *alpha* with a high benchmark correlation. They require managers to be fully invested and the increased volatility will be offset by other investment products. Therefore we have created an institutional product, currently a model portfolio, using the actual composite trades and dividend income of the S&P500/Select. To stay fully invested we replaced the cash account with an Exchange Traded Fund (ETF). In this case we use the State Street Global Advisors SPDR S&P 500 (SPY).

As table 10 illustrates, excess return over the benchmark (alpha) is attained with a high correlation (RSQR) to the benchmark, but with a higher standard deviation (volatility) vs the benchmark. Furthermore, exhibit 11 shows that excess returns can be achieved against the S&P500 as well.

Exhibit 10: 6 Year Statistics (June 2002 – June 2008)					
Institutional LCG vs Russell® Growth					
Alpha	RSQR	Standard Deviation	Tracking Error	Sharpe Ratio	Information Ratio
2.38%	0.89	12.57 vs 12.31	4.20	0.48	0.49

Source: Informa Investment Solutions

**Exhibit 11: Value of \$100 Invested December 2001 to June 2008**  
**Beacon Street Capital - Institutional LCG**

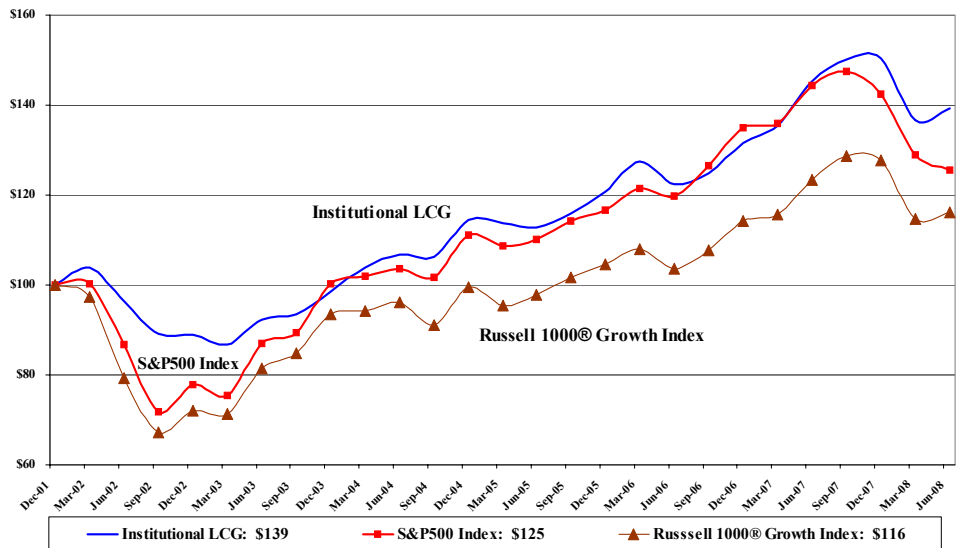


Exhibit 12: Net Returns vs Benchmarks				
	2Q08	1Year	5Yr. Avg.	Inception
Institutional LCG	1.98%	-5.82%	9.84%	4.10%
Russell 1000® Growth Index	1.25%	-5.95%	7.32%	2.33%
S&P 500 Index	-2.73%	-13.12%	7.58%	3.55%

Terry E. Burke  
Chief Executive Officer

## About the Firm

Beacon Street Capital provides affluent individuals and business professionals in the Southeast with a conservative, consistent, long-term approach to managing money that has generated excess returns with reduced volatility. Our strategy reflects sound investing principles, delivered with a sophisticated level of financial services. We believe our clients deserve nothing less.

We select for our clients individual equity securities that show positive internal growth potential and financial strength. These securities are held and actively monitored in a separately managed account held by an independent custodian, and we provide detailed quarterly updates.

Whether growing assets for retirement or building a family estate, we believe that wealth properly managed is wealth with a future. Please contact us to explore how we can help you with this process.

### Definitions:

<sup>1</sup> *Standard Deviation*: A measure of volatility, or the range of a portfolio's performance. The more an investment's return varies from its average, the higher the standard deviation. Unlike *beta*, which measures volatility relative to the market, standard deviation is a measure of total risk, or the total variation of the return. The lower the standard deviation the lower the risk, or volatility of the portfolio.

<sup>2</sup> *Sharpe Ratio*: A measure of risk-adjusted return. The Sharpe Ratio incorporates the standard deviation and the excess returns over 90-day Treasury bills to measure the reward per unit of risk. The higher the ratio over 0.0 the better the investment's historical risk-adjusted performance.

<sup>3</sup> *Information Ratio*: One of the most important tools for measuring the performance of an active manager against an appropriate benchmark. It is the ratio of excess returns to standard deviation of excess returns of the portfolio, and is used to estimate the return added by the manager for each 1% of risk added by the manager. A 5-year average *Information Ratio* over 0.50 is considered "good", over 0.75 "very good", and over 1.00 "exceptional".

<sup>4</sup> *Beta*: Measures volatility in relation to the benchmark (or market). A portfolio with a *beta* of 1.5 means that the portfolio return is expected to move 1.5 times the benchmark return. If the benchmark return is 10%, the portfolio return is expected to be 15%. If the benchmark return is -10%, the portfolio return is expected to be -15%. A low *beta* represents lower volatility, which is often associated with low returns; a high *beta* represents higher volatility, which is often associated with high returns. It is unusual to have a combination of high returns and low volatility. However, a good manager picking outstanding stocks can provide excess returns without adding excess risk. This is called "adding *alpha*".

<sup>5</sup> *Alpha*: Measures the return added by the manager. It is the excess return over the benchmark return, adjusted for volatility.

<sup>6</sup> *R-Square*: Measures the correlation between the portfolio return and the benchmark return, or how well they fit from a statistical standpoint. A correlation of a 1.00 means a perfect fit and any number over .70 means the *Alpha* and *Beta* measurements are meaningful.

<sup>7</sup> *Tracking Error*: The standard deviation of the excess returns. The lower the tracking error the lower the risk.

<sup>8</sup> *Russell-1000® Growth Index*: This Index is more representative of the overall large capitalization market and thus more representative of our investment style. It is also widely used by institutional consultants, such as *Informa Investment Solutions Inc.*, which tracks and reports our performance through its *PNS Manager Database*, when seeking investment managers for their clients.